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CRA GUIDANCE ON FOREIGN ACTIVITIES CHANGES RULES ON CAPITAL PROPERTY IN A FOREIGN COUNTRY

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A. INTRODUCTION

CRA Guidance – CG–002 "Canadian Registered Charities Carrying Activities Outside of Canada" ("The Guidance")[1] has been amended by replacing Appendix B entitled "What if a charity helps build capital property in a foreign country?", with a new Appendix B now entitled "What if a charity wants to transfer capital property to a non-qualified donee in a foreign country?" The Guidance was originally released on July 8, 2010. The exact date that Appendix B was replaced by CRA is not known, but it would appear that the amendment may have occurred on June 14, 2012, being the "date modified" indicated in the online version of the Guidance accessed on June 27, 2013. To our knowledge, no notice was given by CRA concerning this amendment, which is surprising given the fact that the changes in the wording set out in Appendix B, as explained below, are not of an insignificant nature.

B. COMPARISON OF CHANGES

In the original version of the Guidance, the key provisions of Appendix B explained how a charity could build or help build capital property in a foreign country and read as follows:

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[1] Available online at: http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html.

What if a charity builds or helps build capital property in a foreign country?

A charity may want to buy or build, or help buy or build, real or capital property in a foreign country, such as land or buildings. However, the charity may find that owning real or capital property is not practical or possible. For example, some countries do not permit foreign ownership of real property, or it could be extremely difficult to operate and maintain a building in another country.

In these cases, a charity may seek to transfer ownership of real or capital property to a foreign non-qualified donee. These types of transfers can be problematic because land and buildings tend to have a relatively high value, and can also be used for a wide variety of purposes. For example, a charity might help an impoverished community build a bridge that allows people to cross a river and take their goods to a local market more quickly. Then a powerful member of that community may seize control of the bridge and start charging a toll for personal profit.

Transferring ownership of capital property to a local organization or government body might be acceptable to the CRA, as long as documentation with any non-qualified done states that the property will be used only for charitable purposes. The charity should get reasonable assurances, and document and retain these assurances, that the property will, at least for its expected useful life, be used for the benefit of the community as a whole.

The charity should also, to the best of its ability, assess the risk that its property is likely to be used inappropriately. If the risk of inappropriate use outweighs the benefit that is likely to be provided, the charity should not start, or should stop, the project.

*Accessed on August 9, 2010 and archived by the authors.

The key provisions of the new Appendix B of the Guidance (including a new name for Appendix B) now reads as follows, with substantive changes to Appendix B (as determined in the opinion of the authors) being underlined for ease of reference:

What if a charity wants to transfer capital property to a non-qualified donee in a foreign country?

A charity may want to acquire land or buildings in another country, but find that owning capital property in that country is impossible. Or a charity might already own capital property in a foreign country, but a change in circumstances makes continued ownership impossible. In these cases, a charity may want to transfer ownership of the capital property to a foreign organization that may be a non-qualified donee. <u>As a rule, transferring ownership of capital property to any non-qualified donee, including a local organization or government body, is not permitted. This is because land and buildings might be used for non-charitable purposes. However, transfers to non-qualified donees might be acceptable in the following three situations:</u>

- the country in which the charity is operating does not permit foreign ownership of capital property; or

- the capital property is transferred only as part of a development project to relieve poverty by helping a community to become self-sufficient; or

- the charity can show that it has made every reasonable effort to gift the capital property to another qualified donee, and has made every reasonable effort to sell the capital property for its fair market value, but has not been successful."

A development project is generally one where turning over the property to a local organization is integral to giving a deprived community the means to break free of the cycle of poverty and disease. This may include, for example, projects such as schools and hospital buildings.

In any of the three scenarios above, a charity should make sure that the organization it is transferring the property to has a mandate that is consistent with ensuring the continued charitable use of the property. The charity should get documentation from the non-qualified donee stating that the capital property will be used only for charitable purposes. Also, the charity should get, document, and keep reasonable assurances that the property will, for its expected useful life, benefit the whole community.

The charity should also, to the best of its ability, assess the risk that its capital property might be used inappropriately. If the risk of inappropriate use is greater than the benefit that may be provided, the charity should not transfer ownership of the property. Before transferring ownership of any capital property, and particularly in the case of the third scenario in the above list, we recommend contacting the Charities Directorate to consider the available options. [emphasis added]

C. COMMENTARY

What is obvious from comparing the two versions of Appendix B of the Guidance set out above is that CRA has now made it much more challenging for a charity operating in a foreign jurisdiction to transfer ownership of real property to a non-qualified donee.[2] This is surprising because Appendix F of the Guidance, which sets out the basic elements of a written agreement between the parties in this situation, still makes reference to the less onerous requirements of the old version of Appendix B by continuing to state the following:

[2] Subsection 149.1(1) of the *Income Tax Act* (Canada) ("ITA") provides that qualified donees are organizations that can issue official donation receipts for gifts that individuals and corporations make to them under paragraphs 110.1(1)(a) and (b) and 118.1(1) of the ITA. A non-qualified donee is any organization that is not a qualified donee. Qualified donees consist of registered charities, registered Canadian amateur athletic associations, certain low-cost housing corporations for the aged, municipalities, provincial and federal governments, the United Nations and its agencies, prescribed universities outside Canada, charities outside Canada to which the federal government has made a gift in the past 24 months, and registered national arts service organizations.

- "If any of the charity's funds or property are to be used in the acquisition, construction, or improvement of immovable property, the title of the property will vest in the name of the charity. If not, there will be:

    - provision indicating how legal title to that property shall be held (in the name of a local charity, government agency, municipality, or non-profit organization established to provide benefits to the community at large);

    - provision for the intermediary to get reasonable assurances from the property holder, owner, or landlord, as the case may be, that the property will continue to be used for charitable purposes for the benefit of the public;"

The unchanged wording in Appendix F of the Guidance (i.e. reflecting the previous wording of Appendix B) will presumably now need to be read subject to the more onerous requirements that are in the current version of Appendix B. It is not clear why CRA has felt that the more enhanced requirements relating to the ownership of capital property by a non-qualified donee in a foreign jurisdiction was either necessary or justifiable, as evidence of "direction and control" when working through a third party intermediary. However, what is clear is that these changes in the new Appendix B to the Guidance represents a much more significant set of threshold requirements for charities that may be contemplating transferring capital property to non-qualified donees in a foreign country. As a result, charities will clearly want and need to consult with their legal counsel before embarking on any capital property acquisitions in this context. As well, in relation to those charities that have acquired capital property in the past through non-qualified donees but may not meet the more onerous threshold requirements set out in the new Appendix B of the Guidance, it is hoped that CRA will exercise its administrative discretion and not retroactively apply the new requirements in the revised Appendix B of the Guidance to these charities.